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Litigation and Enforcement Developments

The SPAC Series

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Prof. Michael Klausner
Stanford Law School
+1 650 723 6433
klausner@stanford.edu

Brian Massengill
Partner, Mayer Brown LLP
+1 312 701 7268
bmassengill@mayerbrown.com

Anna Pinedo
Partner, Mayer Brown LLP
+1 212 506 2275
apinedo@mayerbrown.com

Agenda

- Breach of fiduciary duty claims including a discussion of the Delaware Chancery Court's opinion in *In re* Multiplan Corp. Stockholders Litigation and similar cases
- Potential responses to the allegations of conflicts of interest in the SPAC structure
- Federal securities disclosure claims
- Federal securities litigation relating to post de-SPAC disclosures and the impact of short sellers and other market participants
- Enforcement actions
- Importance of adequate diligence of the target and fulsome disclosures to avoid litigation

In re Multiplan Corp. Litigation

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Churchill's IPO and the "Sponsor Promote"

- Churchill III was a Delaware corporation and special purpose acquisition company ("SPAC") that completed an $1.1 billion IPO in February 2020.
  - For $10.00 per unit, the SPAC sold 110,000,000 units consisting of one share of Class A common stock and one fourth of one warrant to purchase a Class A share at a $11.50 exercise price.
  - $1.1 billion was placed in a trust account
- Founders, led by Michael Klein, received a "sponsor promote":
  - 27,500,000 shares of Class B common stock for $25,000 (20% of total common stock)
  - 23,000,000 warrants for $23 million or $1.00 per warrant

Churchill's Corporate Governance

- All shares of Class B stock were held by a sponsor holding company (the "Sponsor") and though directors in the SPAC were given sizable interests in the Sponsor, Klein controlled the Sponsor and had a majority of the Class B shares allocated to him.
- Prior to a business combination, only Class B shareholders could vote on directors. So Klein's control of the Sponsor gave him effective control of the SPAC and its board.
- Directors (other than Klein) were given interests in the Sponsor relating to between 294,985 and 3,933,137 Class B shares
- As with virtually all SPACs, Churchill was required to offer Class A stockholders redemption rights in connection with the closing of any business combination.

Churchill's Business Combination with MultiPlan

- In July 2020, Churchill signed a business combination agreement with MultiPlan, a provider of data analytics technology and cost management solutions platform for the US healthcare industry, and raised $2.6 billion in a PIPE transaction, comprised of new Class A shares, warrants and convertible notes.
- Churchill sent a proxy statement soliciting stockholder approval of the transaction and notifying them of their Class A redemption right. The redemption price was $10.04 per share. As of the stockholder meeting record date, Class A shares were trading at $11.09 per share.
- In October 2020, the business combination was consummated--93% of shares voted in favor of the transaction and less than 10% opted to redeem.

The Litigation

- In November 2020, an equity research firm published a report about MultiPlan, now a publicly traded company, stating that its largest customer UnitedHealth Group ("UHC") – which represented 35% of MultiPlan's 2019 revenues – was developing an in-house data analytics platform called Naviguard and that Naviguard would soon negate UHC's need for MultiPlan.
- MultiPlan's stock price fell the next day to $6.27/share.
- Plaintiffs brought suit in Delaware Chancery Court against Churchill, MultiPlan, the directors, Klein among others for breaches of fiduciary duty in connection with the proxy statement's failure to disclose UHC or Naviguard prior to the vote and redemption deadline.
- Defendants moved to dismiss for failure to plead demand futility and failure to state a claim upon which relief can be granted.

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Procedural Posture

- In ruling on the defendants' motions to dismiss, the court was required to assume that all of the plaintiffs' well-pleaded factual allegations were true and to draw all reasonable inferences in favor of the plaintiffs.
- In its ruling, the court described the crux of the plaintiffs' claims as follows: "the defendants breached their fiduciary duties by prioritizing their personal interests above the interests of Class A stockholders in pursuing the merger and by issuing a false and misleading proxy, harming stockholders who could not exercise their redemption rights on an informed basis."

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Standard of Review

- Default is the deferential "business judgment rule" - presumption that a board of directors acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interest of the corporation.
  - Typically, once this standard is applied, a Delaware court will find for the directors as a court will not substitute its own judgment for the judgment of the board.
- However, the deferential "business judgment rule" standard may not apply in transactions with conflicts of interest. In conflicted situations, Delaware courts can apply the "entire fairness" standard, which shifts the burden to the defendant directors to prove the fairness of the transaction.
- Plaintiffs made two arguments as to why the "entire fairness" standard applied: (i) the Business Combination was a "conflicted transaction," and (ii) a majority of the directors was conflicted either because they were self-interested or not independent.

Conflicted Board

- Court said Klein was a controlling stockholder who received a "unique benefit" from the business combination from his Class B shares. Majority of directors were either self-interested or not independent of Klein, the controlling stockholder, or both.
- Self-interested: Even in a "bad deal" scenario *(e.g.*, stock price falls to $5.00), directors with smallest allocation of Class B shares would hold shares worth over $500,000, even accounting for lock-ups and excluding unvested shares.
- Not independent: (i) Klein appointed and had the unilateral power to remove any director; (ii) the substantial financial incentives described above; (iii) several directors had appointed by Klein as directors of other SPACs with the potential for more large paydays and may have been seeking future appointments; (iv) one of the directors was Klein's brother; and (v) one of the directors was a managing director of another entity controlled by Klein.
- All this was enough on a motion to dismiss to apply "entire fairness."

Ruling

- Motions to dismiss were denied (except with respect to one officer and of the post-combination MultiPlan).
- Viability of the plaintiffs' claims was not due to the nature of the Business Combination or the resulting conflicts alone.
  - [The plaintiffs' claims] are reasonably conceivable because the Complaint alleges that the director defendants failed, disloyally, to disclose information necessary for the plaintiffs to knowledgeably exercise their redemption rights. **This conclusion does not address the validity of a hypothetical claim where the disclosure is adequate and the allegations rest solely on the premise that fiduciaries were necessarily interested given the SPAC's structure.** The core, direct harm presented in this case concerns the impairment of stockholder redemption rights. **If public stockholders, in possession of all material information about the target, had chosen to invest rather than redeem, one can imagine a different outcome.**

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Post-ruling Developments

- MultiPlan defendants submitted their answer to the complaint, strongly contesting the factual allegations relating to its key customer and the motivations of the short seller in issuing its report.
  - Muddy Waters is subject to an SEC investigation relating to its activities and potentially subject to FBI investigation.
  - Describes the extensive diligence including meeting with the key customer and discussing the software being developed.
- The answer stated that the short seller's report was false regarding its key customer, which remains with MultiPlan, the relationship has expanded, and the customer's internal software was not a replacement or competing product.
- Multiplan's results exceeded expectations with revenue growing.
- Motion to dismiss standard with entire fairness review can keep you in cases.

Potential Responses

- Two structural features common to virtually all SPACs resulted in the DE Court of Chancery allowing a direct claim for breach of fiduciary duty and applying the "entire fairness" standard.
  - Differing incentives of Class A versus Class B stockholders
  - Right of Class A stockholders to redeem their shares in connection with a business combination
- Delaware Courts, like the SEC, expect SPACs and SPAC sponsors to undertake rigorous due diligence on target companies up until the business combination. Do diligence.
- SPAC sponsors should analyze their directors for substantial pecuniary interest and other relationships that may suggest affiliations and loyalties to the sponsor.
- Consider procedural enhancements such as a special committee or fairness opinion.

Disclosure-related Claims

Litigation Against SPACs

Misstatement in IPO prospectus	1
Misstatement prior to merger announcement	3
Misstatement in merger proxy	35
Misstatement after merger	49

Note: This does not include merger objection suits, which typically settle for "mootness fees."

Disclosure-related Claims

- Much of the reported litigation "boom" relating to SPACs involves disclosure-related claims filed after the issuance of the preliminary proxy and before completion of the de-SPAC transaction
- These include complaints filed in federal court asserting federal securities claims under Section 14(a) of the Securities Exchange Act and state court complaints asserting breach of fiduciary duty claims alleging purported disclosure deficiencies
- Plaintiffs now are also just issuing demand letters without filing complaints.
- These disclosure-only claims are typically resolved by additional disclosures in an amended proxy or a Form 8-K filing in advance of the shareholder vote
- Plaintiffs' law firms may seek a "mootness" fee
- As with other SPAC-related litigation, claims relating to forecasts can largely be divided into purported disclosure deficiencies asserted prior to the completion of the de-SPAC transaction and post-transaction claims asserted after, for example, earnings fall short of the forecasts

Post de-SPAC Litigation

Claims that May Arise Post-transaction

- A number of claims have been brought after the completion of the de-SPAC transaction where the performance of the stock has disappointed
- These claims primarily have been based on post-transaction occurrences or announcements that resulted in significant stock price declines:
  - Shortfalls to forecasts included in the proxy
  - Loss of key customers
  - Shortseller reports (PureCycle; Clover Health; Nikola Motors)
- The post-transaction events implicate potential conflicts and the decisions and disclosures made in connection with the de-SPAC transaction
- The claims may be brought as breaches of fiduciary duty or as federal securities actions

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Claims that May Arise Post-transaction: Federal Securities Litigation

- The federal securities claims track similar allegations as the fiduciary breach claims
- Will assert securities fraud under Section 10(b) and 20(a) of the Exchange Act
- Claims have also been asserted under Sections 11 and 15 of the Securities Act
  - Challenges to these claims may arise if the plaintiff purchased shares post-transaction
- If the claims are predicated on forecasts or other forward-looking statements made in connection with the de-SPAC transaction, the availability of the Private Securities Litigation Reform Act ("PSLRA") safe harbor with be heavily litigated

Claims that May Arise Post-transaction: Federal Securities Litigation — Delman v. GigAcquisitions3

- Claim:
  - – Gig3 failed to provide shareholders with sufficient information to inform their redemption decision
    - Failed to disclose extent to which cash was dissipated
    - Misstated value of target
- Threshold issues:
  - – Derivative or direct?
  - – Contract or fiduciary duty claim?
  - – Is nonredemption a decision to “hold” shares?
- All issues parallel issues resolved in MultiPlan

Claims that May Arise Post-transaction: Federal Securities Litigation — Clover Health Litigation and Investigation

- Clover Health Investments Corp began trading on Nasdaq in January 2021, after it was acquired by a SPAC (Social Capital Hedosophia).
- On February 4, 2021, Hindenburg Research reported that before the merger, Clover was investigated by the Department of Justice for multiple issues (not disclosed when it went public).
- On February 5, 2021, a securities class action lawsuit was filed in Tennessee district court against Clover Health and certain officers and directors of both Clover and Social Capital, alleging violations under Section 10(b) of the Exchange Act.
- On February 28, 2022, the court denied the motion to dismiss, applying the heightened pleading standards of the PSLRA, for all defendants on all counts.

Enforcement Actions

In the Matter of Momentus, Inc., et al.

- Stable Road Acquisition Corp ("SRAC"), the SPAC, announced a merger with Momentus, Inc. and raised $175 million via a private placement.
- Momentus is an early-stage space transportation company that intends to provide satellite positioning services with in-space propulsion systems powered by proprietary microwave electro thermal thruster water plasma thrusters.
- In its Order Instituting Cease-And-Desist Proceedings, the SEC states that Momentus and SRAC mislead investors regarding:
  - the extent to which Momentus's propulsion technology had been "successfully tested" in space; and
  - the extent to which national security concerns involving Momentus's CEO hindered Momentus from obtaining necessary governmental licenses critical to its operations.

In the Matter of Momentus, Inc., et al.

- As a result of its failure to conduct adequate due diligence, SRAC, according to the complaint, compounded these disclosure violations by repeating materially false and misleading statements in materials presented to investors.
- The SEC claims that these failures amounted to violations of Section 10(b) and Rule 10b-5 of the '34 Act; Section 14(a) and Rule 14a-9 of the '34 Act; and Section 17(a) of the '33 Act.
- Without admitting or denying the SEC's findings, all parties, except for Momentus's CEO settled the charges and the following penalties were imposed:
  - Momentus, SRAC and SRAC's CEO will pay civil penalties of $7 million, $1 million and $40,000, respectively;
  - all subscribers in the PIPE will be given the opportunity to terminate their subscription agreements;
  - the sponsor will forfeit 250,000 founder shares in SRAC; and
  - Momentus will undertake substantial enhancements to its disclosure controls, including the creation of an independent board committee and the retention of an internal compliance consultant for a period of two years.
- The SEC has separately filed litigation against the former CEO of Momentus.

Diligence and Other Steps

Diligence and other steps

- At the SPAC formation stage, consider board composition, independence issues, other affiliations that may not strictly trip the “independence” test, compensation of board members
- Enhanced disclosure of conflicts of interest
- Diligence to be undertaken by persons that may be viewed as “gatekeepers” by the SEC
- Enhanced disclosure of dilution and interests of various parties in the financing transactions that accompany the de-SPAC business combination

Supplemental Materials and Additional Resources

Read:

- Delaware Court of Chancery Allows deSPAC Litigation to Proceed Applying "Entire Fairness" Standard
- The SEC Pursues Action Against SPAC and Insiders for Misleading Investors
- Staying Nimble in the SPAC PIPE Market
- SPAC PIPE transactions: the market matures

Watch:

- MB Microtalk: An Overview of SPACs

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